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VIA ELECTRONIC DELIVERY

Florence E. Harmon
Acting Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: **Comments on Proposed Rule 151A**
Indexed Annuities and Certain Other Insurance Contracts
File Number S7-14-08; Release No. 33-8933

Dear Ms. Harmon:

We are submitting this letter on behalf of the Committee of Annuity Insurers (the "Committee").[1] The Committee is pleased to have the opportunity to offer its comments in response to the request by the Securities and Exchange Commission (the "Commission" or "SEC") in Release No. 33-8933[2] (the "Proposing Release") for comments on proposed rule 151A that would deem certain annuity contracts for state law purposes as not an "annuity contract" or "optional annuity contract" under Section 3(a)(8) of the Securities Act of 1933 (the "1933 Act"). As noted in the Proposing Release, this proposed rule is "intended to clarify the status under the federal securities laws of indexed annuities, under which payments to the purchaser are dependent on the performance of a securities index."[3]

The Committee commends the Commission for its ongoing efforts to enhance consumer protection and for its efforts to provide greater certainty to issuers and sellers of annuity products, including indexed annuities, with respect to their obligations under

[1] The Committee of Annuity Insurers is a coalition of 33 life insurance companies that issue fixed and variable annuities. The Committee was formed in 1981 to participate in the development of federal securities law regulation and federal tax policy affecting annuities. The member companies of the Committee represent over two-thirds of the annuity business in the United States. A list of the Committee's member companies supporting the submission of this letter is attached as Appendix A. The following member companies are not included in Appendix A either because they do not support certain portions of the letter or certain views expressed herein: AXA Equitable Life Insurance Company, Hartford Life Insurance Company, ING North America Insurance Corporation, John Hancock Life Insurance Company, MassMutual Financial Group, Metropolitan Life Insurance Company, New York Life Insurance Company, and Ohio National Financial Services.

[2] See Indexed Annuities and Certain Other Insurance Contracts, Rel. No. 33-8933, 34-58022 (June 25, 2008).

[3] Id. at 1.

the federal securities laws. The Committee agrees that there is no place for inappropriate sales practices involving annuities, just as with other investment or insurance products and services.

The Committee recognizes that there has been uncertainty in the marketplace regarding the status of indexed annuities under the federal securities laws since their introduction in the mid-1990's.[4] Some members of the Committee issue indexed annuities while other members do not. All Committee members, however, issue fixed annuities in one form or another relying upon the Section 3(a)(8) exemption,[5] and adhering to the requirements of the states' insurance laws and regulations.[6] The purpose of this letter is not to comment on whether or not indexed annuities – either generically or with particularity – should be covered by Section 3(a)(8). However, the Committee would like to offer the Commission constructive comments on the Proposing Release as the Commission continues to consider these issues. This letter reflects the input of all Committee members, but because of diverse perspectives of member companies and the shortness of the comment period, there has not been adequate time to reach a complete consensus on all points made in this letter.

First, the Committee is concerned that the rule, if adopted as proposed, would have significant unanticipated consequences, discussed below, for annuity writers far beyond those intended by the proposal. Additionally, because of the unique status of annuities under Section 3(a)(8) of the 1933 Act and existing Rule 151 thereunder, the Committee has significant reservations whether a rule, other than one crafted as a "safe harbor," would be workable, and, as a practical matter, provide more certainty regarding the Section 3(a)(8) status of all fixed annuities not fitting within the Rule 151 safe harbor. To this end, the Committee has outlined the broad contours of an alternative "safe

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[4] See Proposing Release at 8.

[5] Virtually all the indexed annuities issued by Committee members rely on the Section 3(a)(8) exemption.

[6] State insurance regulators have been devoting considerable resources in recent years to strengthening sales and disclosure practices relating to fixed annuities. For instance, the National Association of Insurance Commissioners' ("NAIC") Suitability in Annuity Transactions Model Regulation, adopted in more than 33 states since 2003, imposes a specified supervisory role on insurers with regard to the suitability of annuity sales. The NAIC's Annuity Disclosure Model Regulation, adopted in 22 states, seeks to ensure that purchasers of all annuity contracts understand the basic features of the annuity contract, such as surrender and transaction fees, annuity benefits and other guarantees. Both the consumer and insurance agent are often required to sign these disclosure statements as a condition of policy issuance. Many states also require insurers to deliver a buyer's guide, written by the NAIC, at the point of sale for fixed annuities and for equity-indexed annuities. The NAIC Insurance and Annuity Replacement Model Regulation, adopted in 43 states, requires insurers to develop systems of supervision, control, monitoring and recordkeeping, and to provide consumers with plain-English notices and signed disclosure documents, if a replacement or financed purchase transaction occurs. In addition, annuity writers are subject to state unfair trade practice statutes in all 50 states, which prohibit the misrepresentation of product terms and conditions, and are within the jurisdiction of their state attorneys general.

harbor" rule in Section II below that would take into consideration the investment risk of the insurer and address certain market conduct concerns addressed by the Commission in the Proposed Release. [7]

In addition, the Committee strongly believes and respectfully requests that any adoption by the Commission of a rule that would require registration of annuities, other than variable annuities, be accompanied by an appropriate package of rules that would level the SEC playing field for registered fixed annuities relative to variable annuities, consistent with the proposed exemption from the periodic reporting requirements of the Securities Exchange Act of 1934 (the "1934 Act" or the "Exchange Act") in proposed rule 12h-7.[8]

The first section of this letter sets forth some of the Committee's specific legal concerns and responses to the Commission's questions on proposed rule 151A. The second section lays the groundwork for, and provides a broad outline of, the Committee's suggestion regarding an alternative approach to proposed rule 151A. The third section provides the Committee's request for a complete package of reforms relative to registered fixed annuities, and the last section of this letter requests that the effective date of an adopted rule regarding Section 3(a)(8) be at least 24 months after publication in the Federal Register.

I. The Committee's Concerns with Proposed Rule 151A

Proposed rule 151A would define a class of annuity that would ***not*** be able to rely on the exclusion for annuity or optional annuity contracts in Section 3(a)(8) of the 1933 Act. Issuers of annuities would be required to determine whether an annuity fit within the broad scope of the rule. If proposed rule 151A applies, then the insurer must determine whether the annuity falls within or outside the definition of "not" an annuity. Absent another exemption, annuities that meet this definition would be required to be registered as securities. The status under the 1933 Act of annuities that fell outside the definition "would continue to be determined by reference to the investment risk and marketing tests articulated in existing case law under Section 3(a)(8) and, to the extent applicable, the Commission's safe harbor rule 151."[9]

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[7] The Committee's work on developing a framework for an alternative rule is still in progress and, despite an intense dedication of resources, could not be completed by the Commission's September 10 deadline for comment. The length of the deliberative process involved in crafting the contours of an alternative rule proposal was one of the reasons the Committee requested an extension of the comment period. <u>See</u> Letter to Florence E. Harmon, Acting Secretary, U.S. Securities and Exchange Commission from the Committee of Annuity Insurers, File Number S7-14-08 (August 5, 2008).

[8] The Committee is submitting a separate comment letter on proposed rule 12h-7.

[9] Proposing Release at 46.

The definition of an annuity that is not an "annuity contract" under Section 3(a)(8) has two parts. Under proposed rule 151A, an annuity would be subject to registration if:

(1) Amounts payable by the issuer under the contract are calculated, in whole or in part, by reference to the performance of a security,[10] including a group or index of securities; and

(2) Amounts payable by the issuer under the contract are more likely than not to exceed the amounts guaranteed under the contract.[11]

The proposed rule specifically excludes a contract whose value varies according to the investment experience of a separate account.[12] However, no other contracts are expressly excluded, and the proposed rule's conclusive determination of securities status does not include any consideration of other factors deemed relevant by the courts in evaluating whether a contract falls within the Section 3(a)(8) exclusion.

As noted above, while the Committee is supportive of SEC efforts to provide regulatory certainty regarding the status of indexed annuities under the federal securities laws, the Committee has two serious concerns with the approach and framework of proposed rule 151A:

- The test set forth in proposed rule 151A is unprecedented, departs from established U.S. Supreme Court and Commission precedent, and raises difficult interpretative issues for the fixed annuity industry; and

- In practice, the approach in proposed rule 151A, which makes a conclusive securities determination based on limited factors, could very well undermine the "safe harbor" character of Rule 151 and operate to create significant uncertainty about the securities status of the many unregistered fixed annuities not fitting within Rule 151.

The discussion below elaborates further on these critical concerns, providing the Committee's considered position on the unanticipated consequences for the industry as a whole, if the Commission were to adopt rule 151A as proposed.

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[10] "Security" would have the same meaning it has in Section 2(a)(1) of the 1933 Act. See id. at 32.

[11] See id. at 93-94.

[12] Proposed rule 151A(c), id. at 94.

A. Discussion and Overview of Supreme Court Precedent

The Proposing Release discusses and quotes extensively from the two seminal Supreme Court cases interpreting Section 3(a)(8) of the 1933 Act, the VALIC and United Benefit cases.[13] The annuities at issue in those cases were fundamentally variable annuities, where the purchaser assumed virtually the entire investment risk, particularly the risk of significant loss of principal due to negative investment performance. With respect to this investment risk assumption, the annuities in VALIC and United Benefit are clearly distinguishable from fixed annuities with minimum guaranteed values that equal or exceed those required by applicable state nonforfeiture laws, and that credit only positive interest, which proposed rule 151A would treat as securities.[14]

The VALIC opinion explains that "the variable annuity places all the investment risks on the annuitant, none on the company."[15] VALIC also noted that the return on a variable annuity depends "on the wisdom of the [company's] investment policy."[16] Those crucial factors would not be present in many of the fixed annuity designs that would be covered by proposed rule 151A. Specifically, where fixed annuities comply with state fixed annuity nonforfeiture laws and credit only positive interest that is not a pass-through of the performance of a managed investment policy: (1) any investment risk assumed by the purchaser is much less significant, and (2) the issuing company certainly assumes substantial investment risk. The VALIC opinion also referred to the variable annuity as having "no element of a fixed return."[17] In contrast, all fixed annuities that guarantee minimum values equal to or exceeding those required to comply with state fixed annuity nonforfeiture laws have a very substantial element of a fixed return.[18]

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[13] S.E.C. v. Variable Annuity Life Ins. Co., 359 U.S. 65 (1959) ("VALIC"); S.E.C. v. United Benefit Life Ins. Co., 387 U.S. 202 (1967) ("United Benefit").

[14] In a discussion of the VALIC case, the SEC staff noted in its 1987 report that "[u]nder a variable annuity contract, a contract owner's purchase payments are invested in a pool of securities and benefits under the contract that vary directly with the pool's investment performance. In the purest form of variable annuities, the insurer does not guarantee any level of benefits and does not assume any investment risk." Report of the Division of Investment Management of the Securities and Exchange Commission Regarding the Securities Act Status of Guaranteed Investment Contracts and the Investment Company Act Status of Issuers of Such Contracts 3 (Jan. 20, 1987) ("1987 Report").

[15] VALIC, 359 U.S. at 71 (emphasis added).

[16] Id. at 70.

[17] Id. at 71.

[18] The NAIC standard nonforfeiture law for individual deferred fixed annuities provides that interest rates calculated in accordance with the model law must be credited to at least 87.5% of gross premiums decreased by the sum of (i) any prior withdrawals accumulated at rates of interests indicated by the model law, (ii) an annual contract charge of $50, accumulated at rates of interests specified in the model law, (iii) any premium tax paid by the company for the contract, accumulated at rates of interests specified in the model law, and (iv) any indebtedness. The interest that must be credited is the lesser of 3% per annum and

United Benefit also involved what is fundamentally a variable annuity, where "the insurer promises to serve as an investment agency and allow the policyholder to share in its investment experience."[19] United Benefit provided guarantees not present in the VALIC variable annuity – specifically it guaranteed that the surrender values in year one would not be less than fifty percent of premium grading up to 100% of premium in year ten. The Court dismissed the guaranteed minimum values as "insignificant," noting that "[t]he record shows that United Benefit set its guarantee by analyzing the performance of common stocks during the first half of the 20th century and adjusting the guarantee so that it would not have become operable under any prior conditions."[20]

By contrast, state fixed annuity nonforfeiture laws guarantee that a contract owner will receive no less than 87.5% of premiums if the contract is surrendered in the first year. Those laws require that interest be added to that amount at a rate between 1.0 and 3.0% for the life of the contract. While it is true that, if interest on the 87.5% of premium were accrued at the minimum rate of 1.0%, it would take more than 10 years for a purchaser to be guaranteed a return of the principal amount paid, this guarantee is much more significant than the 50% guarantee promised by United Benefit, and was determined by the NAIC to balance protections to consumers with the acquisition costs and other legitimate expenses insurers typically incur in issuing and administering fixed annuities. It was not set or adjusted with reference to the long-term performance of any security, group of securities or index of securities such that the guarantees would never become operable relative to that performance.[21] And fundamentally, unlike the variable contracts at issue in VALIC and United Benefit, fixed annuities complying with state fixed annuity minimum nonforfeiture laws necessarily do not require special modifications of state law.[22]

The Proposing Release states that the annuities that would fall within proposed rule 151A "are similar in many ways to mutual funds, variable annuities, and other

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the five-year Constant Maturity Treasury Rate reported by the Federal Reserve no longer than 15 months before the contract issue date or the date of redetermination, reduced by 125 basis points (225 basis points on indexed annuities – this reduction must reflect the value of the indexed benefit, and the insurer must demonstrate by actuarial memo that the market value of the benefit does not exceed the present value of the additional 100 basis point reduction), where the resulting interest rate is not less than 1%. See NAIC Standard Nonforfeiture Law for Individual Deferred Annuities, NAIC Model Laws, Regulations and Guidelines 805-1 (2007).

[19] United Benefit, 387 U.S. at 208.

[20] Id. at 209 and n. 12. The Court also noted that the United Benefit contract required "special modifications of state law," and that the guaranteed minimum at maturity was "significantly less than that guaranteed by the same premiums in a conventional deferred annuity contract." Id. at 209.

[21] Id. at 209 n. 12.

[22] Id. at 211.

securities,"[23] and that the purchaser of such an annuity "assumes many of the same risks that investors assume when investing in mutual funds, variable annuities, and other securities."[24] The Proposing Release reaches these conclusions by focusing entirely on the possibility of receiving indexed or other excess interest calculated by reference to a security, including a group or index of securities.[25]

However, the principal investment risk borne by purchasers of mutual funds and variable annuities, and the risk which the U.S. Supreme Court clearly focused on in VALIC and United Benefit in concluding that the contracts at issue fell outside the Section 3(a)(8) exclusion, is the risk of a decline in the value of their investment due to a decline in the market value of the underlying securities (i.e., a loss of principal due to a decline in market value). Products which comply with state fixed annuity nonforfeiture laws and which do not allow for 'negative' interest to be credited are fundamentally different products.

The Committee believes this very basic and fundamental distinction between fixed annuities complying with state fixed annuity nonforfeiture laws and the variable annuities that were addressed in VALIC and United Benefit is critical and should be factored into any analysis of the status of fixed annuities under Section 3(a)(8). The Proposing Release and the test in proposed rule 151A do not appear to do so in any meaningful way.

B. Any Test Used to Determine the Securities Status of Fixed Annuities under Section 3(a)(8) Should Take into Consideration the Investment Risk Borne by the Company

The analysis in the Proposing Release focuses almost entirely on the investment risk borne by the purchaser, and largely overlooks or discounts the investment risk borne by the insurer. As a result, the test for when an annuity falls outside Section 3(a)(8) found in paragraph (a)(2) of proposed rule 151A focuses only on the possible investment risk borne by the purchaser – the likelihood of receiving any indexed or other excess interest calculated in whole or in part by reference to a security, including a group or index of securities. However, the VALIC and United Benefit cases clearly require that the investment risk borne by the company be taken into account – indeed, it is a key factor in the Supreme Court's interpretation that a Commission rule interpreting Section 3(a)(8) should not ignore.[26]

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[23] Proposing Release at 27.

[24] Id. at 32.

[25] Indeed, the test in paragraph (a)(2) of proposed rule 151A is based entirely on this factor.

[26] The investment risk borne by the insurer is, of course, also a key factor in how other federal courts have interpreted and applied Section 3(a)(8). See, e.g, Olpin v. Ideal Nat'l Ins. Co., 419 F.2d 1250, 1262-63 (10th Cir. 1969) ("Olpin") (insurer bore sufficient investment risk when it was obligated to pay an amount

The VALIC court's decision was based on the fundamental fact that the variable annuity at issue in the case places all of the investment risk on the purchaser, and none on the insurance company. The VALIC court found that "the concept of 'insurance' involves some investment risk-taking on the part of the company" (emphasis added),[27] that "the issuer of a variable annuity that has no element of a fixed return assumes no true risk in the insurance sense" (emphasis added),[28] and that with the variable annuity, there "is no true underwriting of risks, the one earmark of insurance as it has commonly been conceived of in popular understanding and usage" (emphasis added).[29] The Court's analysis, and these statements, clearly mean that the company's assumption of risk is not only a relevant factor, but a critical factor, in any section 3(a)(8) analysis.[30] Because proposed rule 151A focuses only on the likelihood of excess interest being included in amounts payable under the contracts, and does not factor in the degree of investment risk borne by the insurer, it prompts significant interpretive issues regarding the scope of the of the Section 3(a)(8) exclusion and raises the fundamental question whether proposed rule 151A is in effect "defining away" fifty years of the Supreme Court's interpretation of a Congressionally enacted statute.[31]

C. In Evaluating the Investment Risk Borne by the Purchaser, the Singular Focus of the "More Likely Than Not" Test on the Possibility of Receiving Interest Above the Guaranteed Minimum Is Inconsistent with the Investment Risk Analysis Required by Section 3(a)(8) Precedents

The "more likely than not" test in paragraph (a)(2) of proposed rule 151A focuses on a single factor – the likelihood that excess interest will be credited (*i.e.,* if the amount payable, which includes excess interest, is more likely than not to exceed the guaranteed amount more than half the time). This is not consistent with the entire body of Section 3(a)(8) jurisprudence, which teaches that all of the relevant facts and circumstances

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that could be mathematically calculated, and given the insurer's unconditional obligation to pay); Associates in Adolescent Psychiatry v. Home Life Ins. Co. of New York, 729 F. Supp. 1162 (N.D. Ill. 1989), aff'd, 941 F.2d 561, 565 (7th Cir. 1991) (Home Life assumed sufficient investment risk for the contract to be deemed "insurance" within the meaning of Section 3(a)(8)); Berent v. Kemper Corp., 780 F. Supp. 431,441 (E.D. Mich. 1991), aff'd 973 F.2d 1291 (6th Cir. 1992) (single premium whole life insurance policy).

[27] VALIC, 359 U.S. at 71.

[28] Id.

[29] Id. at 73.

[30] United Benefit followed the Court's reasoning in VALIC.

[31] In defining contracts that are not "annuities" within the meaning of Section 3(a)(8), the approach embodied in proposed rule 151A is in effect an interpretation of the outer bounds of Section 3(a)(8), and therefore should be consistent with judicial interpretations of the statute. Compare the Rule 151 safe harbor.

related to the investment risk assumption must be considered in determining whether a contract does not fit within the Section 3(a)(8) exemption.[32] Section 3(a)(8) simply does not permit a determination under that statute to be made based solely on a single component of investment risk – and the proposed rule focuses only on a single, and what frequently may be a relatively minor, component.

Judicial interpretations of Section 3(a)(8),[33] as well as the Commission's previous interpretations,[34] have required an evaluation of the total investment risk borne and not borne by the purchaser, and required a weighing of the investment risk borne by the company against that borne by the purchaser.

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[32] See, e.g., Grainger v. State Security Life Insurance Co., 547 F.2d 303 (5th Cir. 1977), cert. denied sub. nom. Nimmo v. Grainger, 436 U.S. 932 (1978) ("Grainger") (considering contractual terms and promotional materials). It is also inconsistent with the Commission's own prior interpretations, which refer to a general facts and circumstances analysis. See, e.g., Definition of Annuity Contract or Optional Annuity Contract, Rel. No. 33-6645 (May 29, 1986) ("Release 6645") (adopting Rule 151) at 11 ("The presence or absence of a mortality risk assumption may be an appropriate factor to consider in a general facts and circumstances analysis under section 3(a)(8).") (emphasis added).

[33] See, e.g., VALIC, 359 U.S. at 71 ("The difficulty is that, absent some guarantee of fixed income, the variable annuity places all the investment risks on the annuitant, none on the company."); United Benefit, 387 U.S. at 208 (the level of investment risk assumed by the insurer was "insignificant"); Olpin, 419 F. 2d at 1260-63 (balancing risks to insurer against policyowner).

[34] Of particular relevance is the amicus brief that the Commission, through the Solicitor General's Office, filed with the Supreme Court in 1988 urging the Court to grant certiorari to review and reverse a Seventh Circuit decision in Otto v. VALIC. See Brief for the United States as Amicus Curiae, Variable Life Annuity Insurance Co. v. Otto, 486 U.S. 1026 (May 23, 1988) (denying certiorari) ("Amicus Brief"). In that case, Otto v. Variable Annuity Life Insurance Co., 814 F.2d 1127 (7th Cir. 1986), rev'd on rehearing, 814 F.2d 1140 (1987), modified (1987), cert. denied, 486 U.S. 1026 (1988) ("Otto v. VALIC"), the Seventh Circuit had found that one of VALIC's fixed annuities was a security outside Section 3(a)(8) when the contract permitted VALIC, at its discretion, to credit excess interest above the guaranteed rate and to change that excess interest rate at any time – a holding that focused on risk borne by the purchaser of whether excess interest would be credited. The SEC's Amicus Brief argued that the VALIC annuity should qualify for the Section 3(a)(8) exemption because "the meaning of Section 3(a)(8) should be answered by reference to VALIC and United Benefit," and that, "[u]nder those authorities – as well as the relevant announcements of the Commission – it is clear that the assumption of substantial 'investment risk' by the insurance company is one critical factor." Amicus Brief at 6. The SEC's amicus brief stated that the protection of the federal securities laws "is not needed if, inter alia, the insurance company assumes a sufficient share of the investment risk, which reduces the risk to the participant, who is also protected by state regulation of the insurance company. Even though the participant bears some degree of risk, the contract may qualify under the 'annuity contract' exemption." Id at 7. "VALIC assumed sufficient investment risk under the fixed annuity contract sold to Otto," id., the Amicus Brief argued, because the company guaranteed principal and accrued interest and the value of Otto's contract did not vary according to the investment experience of a separate account. The Amicus Brief recognized that the purchaser did bear "the risk that [the] excess interest rate. . . could be reduced or eliminated at VALIC's discretion." Id. at 8. But the Amicus Brief concluded that the Section 3(a)(8) exclusion "should not be limited to annuities with only guaranteed interest rates and no discretionary-interest component…", id., even if that excess interest rate was completely within the control of the insurer.

Proposed rule 151A, however, focuses solely on whether any indexed or excess interest is likely to be paid, and not even on the potential amount of indexed or other excess interest relative to any guaranteed amount. There is no weighing or measuring the amount of excess interest compared to the amount of guaranteed interest or the amount of principal guaranteed. There is no assessment of where the preponderance of the risk lies. For example, assume an annuity contract has a guaranteed minimum credited interest rate of 4.00 % per year but the amount payable more than half the time would include 0.10% excess interest tied to an index, for a total of 4.10 % per year. Proposed rule 151A would make that annuity a security.[35] The Proposing Release does not address this lack of proportionality. It is very hard to see how a purchaser of that kind of product would be "vitally interested in the investment experience,"[36] as the Proposing Release suggests.

It is the Committee's view that any rule interpreting Section 3(a)(8) must consider the investment risk borne by the company and give it due regard. This requires an analysis of the guarantees provided by the company and therefore the risks not assumed by the purchaser, including: (1) guarantees of principal, (2) guarantees of, and the level of, any minimum credited interest rate reflected in minimum nonforfeiture values or otherwise, (3) guarantees of previously credited interest, (4) any contractually prescribed formulas to which the insurer must adhere in crediting indexed or excess interest, and (5) the investment risk aspects of the particular interest crediting mechanism.[37] The costs, and the limitations on and uncertainty of, the company's ability to hedge against its risks should also be considered.

D. Other Factors May Be Relevant in Determining Whether a Contract Falls Outside the Section 3(a)(8) Exclusion

The courts have made clear that marketing can also be a relevant factor in a Section 3(a)(8) analysis.[38] Indeed, the Commission included an explicit requirement in

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[35] This would be result of the proposed rule regardless of how much the marketing emphasized the guarantee of principal and the guaranteed minimum interest rate and other insurance, safety, and soundness features.

[36] Proposing Release at 27.

[37] For indexed annuities, relevant factors would include the establishment of the precise terms of the index interest crediting method prospectively, at the beginning of each term. Other relevant factors would include consideration of the guaranteed limits on the company's ability, for the life of the contract, to change the terms of the excess interest crediting method (*i.e.*, limits on changes in caps, participation rates, spreads, etc.).

[38] See, e.g., United Benefit, 387 U.S. at 211 (citing the marketing test the Court had articulated in SEC v. Joiner Leasing Corp. 320 U.S. 344, 352-53 (1943): "The test . . . is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect."); Grainger, 547 F.2d at 306 (a court should go beyond the four corners of the insurance contract and consider advertising and promotional efforts in making Section 3(a)(8) determination); Berent v. Kemper, 973 F.2d 1291 (6th Cir. 1992) (policies in question were marketed primarily as insurance).

Rule 151 that a fixed annuity must not be "marketed primarily as an investment." [39] Likewise, in the Proposing Release, the SEC itself acknowledges that marketing "is another significant factor in determining whether a state-regulated insurance contract is entitled to the Securities Act 'annuity contract' exemption."[40] Yet the two-pronged test of proposed rule 151A fails to consider marketing as a factor that should be given any weight in determining the securities status of a fixed annuity.

In addition, judicial interpretations of Section 3(a)(8)[41] and the Commission itself[42] have made clear that the company's assumption of mortality risk is also relevant to an analysis under Section 3(a)(8). By failing to include any consideration of these factors in its conclusive determination that certain annuity contracts are securities, proposed rule 151A may capture contracts where those factors would affect the Section 3(a)(8) determination. Therefore, the formulation of the proposed rule is overbroad.

Since instead of being a safe harbor, the proposed rule would conclusively bar certain annuity contracts from qualifying for the Section 3(a)(8) exemption, that exclusion should not be premised on one, or even two, factors, but must incorporate consideration of all relevant factors, especially the significant investment risks borne by the company. It is the Committee's view that the Commission should not, by rule or otherwise, exclude from the statutory exemption those annuity contracts that would be well within judicial interpretations of the exemption enacted by Congress.

E. The Treatment of Charges within the Proposed Rule Is Inappropriate

Paragraph (b)(1) of proposed rule 151A prevents the insurance company from taking surrender charges into account in determining "amounts payable" under a contract for purposes of the test, but requires that surrender charges be taken into account in determining "amounts guaranteed" under the contract. Thus, the proposed rule would require that surrender charges reduce the amounts guaranteed but not the amounts payable. This could practically mean that, irrespective of the likelihood of any indexed or excess interest being included in amounts payable under the contracts, annuity contracts with surrender charges might 'fail' the test and become securities, regardless of any other feature, since as long as the surrender charge is in effect, the amount payable

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[39] Rule 151(a)(3).

[40] Proposing Release at 19.

[41] See, e.g., VALIC, 359 U.S. at 71 (the insurer's assumption of mortality risk under an annuity contract "gives [the annuity] an aspect of insurance"); Dryden v. Sun Life Assurance Co. of Canada, 737 F. Supp. 1058 (S.D. Ind. 1989), aff'd without opinion, 909 F. 2d 1486 (7th Cir. 1990) (insurer's obligation to pay the fixed sum death benefit caused it to bear the risk of poor performance of its investments).

[42] See Release 6645 at 88,130 (mortality risk may be an appropriate factor to consider in determining the availability of an exemption from Section 3(a)(8) beyond the scope of Rule 151.

(which must not take surrender charges into account) will exceed the amount guaranteed by at least the amount of the surrender charge.

The Proposing Release attempts to justify excluding surrender charges from amounts payable by stating that the Commission is "proposing this calculation methodology in order to eliminate the differential impact that such charges would have on the determination depending on the assumptions made about contract holding periods."[43] However, that 'differential impact' based on assumed holding periods is equally applicable to the determination of amounts guaranteed. Neither the Proposing Release's rationale nor anything else justifies treating surrender charges differently in determining the amounts payable from the amounts guaranteed.

More fundamentally, bona fide surrender charges (those that are established by the terms of the contract, without any reference to market factors) are not properly an element of investment risk, and there is no precedent for treating them as such. They are the equivalent of a front-end sales load, or a commission on the purchase of stock; such charges are simply a transaction expense, not an element of investment return. Indeed, in adopting Rule 151, the Commission itself recognized that a surrender charge "normally does not shift additional investment risk to the contractowner."[44]

F. The Scope of the Proposed Rule Is Overly Broad and Will Create Uncertainty Regarding the Securities Status of Fixed Annuities Not Fitting Within the Rule 151 Safe Harbor

The Commission is proposing that an annuity for state law purposes would not be an annuity under Section 3(a)(8) if the amounts payable by the insurance company under an annuity are "calculated in whole or in part by reference to the performance of a security, including a group or index of securities." [45] The Commission intends to "define the class of contracts that is subject to scrutiny broadly,"[46] so that the proposed rule would, by its terms, "apply to indexed annuities but also to other annuities where amounts payable are calculated by reference to a single security or any group of securities."[47] If payments under an annuity are "calculated by reference to the performance of a security or securities, rather than being paid in a fixed amount," the Commission notes that "some investment risk relating to the performance of the securities is assumed by the purchaser" and so the annuity is subject to scrutiny. Read

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[43] Proposing Release at 40.

[44] Release 6645 n. 20.

[45] Proposing Release at 46.

[46] Id. at 31.

[47] Id. at 32.

literally and defined broadly, certain excess interest fixed annuities, possibly even some within the Rule 151 safe harbor, may be deemed securities under the proposed rule 151A test, if the issuer of the fixed annuity calculates excess interest "by reference to" the performance of the securities held in its general account.

The Commission is saying in the Proposing Release that an annuity that has any connection to a security[48] should be subject to the heightened scrutiny of proposed rule 151A, even if the annuity credits interest annually and complies with state fixed annuity nonforfeiture regulations. Yet the Commission in 1986 had a very different understanding, recognizing that "consideration of the investment aspects of [an annuity] is a natural consequence in any discussion of the traditional long-term nature of annuities."[49] Indeed, when discussing the marketing test in 1986, the Commission recognized that a fixed annuity that could "pass" Rule 151 has both "insurance and investment features."[50]

The potential reach of proposed rule 151A, then, is extremely broad and this shift in paradigm could have significant unwarranted consequences for fixed annuity writers. Not only indexed annuities, but also unregistered market value adjusted annuities, certain funding agreements and group annuities that currently rely on Section 3(a)(8) and calculate contract values and credit interest by taking into account the performance of specific securities, groups of securities or securities indices would likely be caught by the proposed rule. Depending on how broadly "calculated, in whole or in part, by reference to" is interpreted, discretionary excess interest contracts qualifying for Rule 151 that specify in the contract or in marketing materials that the declared rate of interest is calculated by reference to certain general account holdings or U.S. Treasury or other securities also could get swept into proposed rule 151A.[51] Even traditional participating policies with dividend formulas which have an investment component arguably might be subject to the rule depending upon the formula and the information publicly available about the formula.

Even if the reach of the rule were narrowed, the Committee is concerned that any rule conclusively defining certain types of fixed annuities to be securities may create unacceptable risks and uncertainties for many, if not most, issuers of fixed annuities not

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[48] The Commission indicates that the term "security" in proposed rule 151A should be interpreted liberally and would have the same broad meaning as in Section 2(a)(1) of the 1933 Act. See Proposing Release at 32.

[49] Release 6645 at n.45.

[50] Id. at 42.

[51] The vagueness of the meaning of the phrase "calculated, in whole or in part, by reference to the performance of a security" in proposed rule 151A is also of significant concern to the Committee, and the Committee strongly urges the Commission not to include broad terms in an adopted rule without specific guidance on their meaning. See proposed rule 151A (a)(1); Proposing Release at 93.

fitting within the Rule 151 safe harbor. When the Commission adopted Rule 151 in 1986, it was emphatic that the Rule was a safe harbor[52] and that annuities not fitting within the safe harbor could nonetheless qualify for the Section 3(a)(8) exemption, depending upon the total facts and circumstances. But a rule as broad as proposed rule 151A, that requires insurers to affirmatively conclude when an annuity is outside 151A, would seem necessarily to increase the odds that courts will struggle to define Section 3(a)(8) beyond the confines of Rule 151.[53] Companies issuing contracts not fitting into either Rule 151 or proposed rule 151A will face conflicting standards in determining whether the contract is entitled to rely upon the Section 3(a)(8) exemption. More specifically, they will find it extremely difficult to analyze their products against both the investment risk principles of Rule 151 and its supportive case law, and the very different unprecedented investment risk principles underlying proposed rule 151A.

Ultimately, this could lead to an unwarranted narrowing of the Section 3(a)(8) exemption so that its outer boundaries are, as a practical matter, defined by the Rule 151 safe harbor. This would be contrary to the Commission's clear intent when it adopted Rule 151 and, we respectfully submit, would operate to stifle innovation, potentially reduce competition, and inflict unnecessary high costs on a critical sector of the financial services industry at a time when the retirement solutions offered by the annuity industry are so important. For this reason, the Committee urges the Commission to approach the securities status of indexed annuities through a safe harbor rule rather than through the approach embodied in proposed 151A. An alternative approach that amended Rule 151, or a new safe harbor that defined when indexed annuity contracts could rely on a safe harbor, would appear to create significantly less legal risk, provide more certainty to insurers generally, and at the same time, by articulating circumstances where indexed annuities do clearly fit within Section 3(a)(8), further the Commission's goals of providing meaningful guidance about when the protections of the federal securities laws

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[52] See Release 6645 at 5 ("Rule 151 is merely a 'safe harbor,' not an all-inclusive definition purporting to encompass every annuity contract that falls within the section 3(a)(8) exclusion. The rule, therefore, does not attempt to identify the outer limits of section 3(a)(8) beyond which a contract, though denominated 'insurance', is a security subject to federal regulation. Rather, the rule simply defines a class of annuities that the Commission believes is clearly entitled to rely on the section. While compliance with rule 151 will assure "non-security status," failure to comply with the rule would not mandate "security status" for an annuity product. Finally, as stated in the proposing release, an insurer offering a contract that, for one reason or another, does not satisfy all of the rule's conditions may still rely directly on section 3(a)(8), albeit with no Commission assurance that the contract is covered by the section 3(a)(8) exclusion.")

[53] Lower courts have had difficulty interpreting Section 3(a)(8) more broadly than the Rule 151 safe harbor. See, e.g., Otto v. VALIC, 814 F.2d at 1141-43 (the court used the investment risk factors articulated in Rule 151 to reach the conclusion that, due the insurer's complete discretion to adjust excess interest rates, the annuity was a security outside the Section 3(a)(8) exclusion); Berent v. Kemper Corp., 780 F. Supp. 431, 441 (E.D. Mich. 1991), aff'd 973 F.2d 1291(6th Cir. 1992) ("SEC Rule 151 . . . sets forth the requirements for exemption of insurance contracts under Section 3(a)(8)"); Rothwell v. Chubb Life Ins. Co. of America, 191 F.R.D. 25 (D. N.H. 1998) (district court used a Rule 151 analysis and found that the insurer retained sufficient investment risk such that life insurance policies were not securities).

would be appropriate for indexed and other annuity contracts that calculate interest by reference to a security, group of securities, or a securities index.

G. The Committee's Concerns with the Manner in Which the Proposed Rule Would Require the Insurer To Make a Subjective Determination that May Lead to Illogical Results

Under proposed rule 151A, a fixed annuity deemed by the rule to be "under scrutiny" will avoid securities status only if the insurer determines, in accordance with paragraph (b) of the rule, that the amounts payable under the contract more likely than not would not exceed the amounts guaranteed under the contract.[54] The Proposing Release makes clear that the insurer bears the burden of proving that the Section 3(a)(8) exemption applies and "would – if challenged in litigation – be required to provide that its methodology and its economic, actuarial, and other assumptions [used in making the determination] were reasonable, and that the computations were materially accurate."[55]

The Commission gives little definitive interpretative guidance on how the industry should determine when an annuity falls within or without the proposed rule's "more likely than not" test, other than to say that the rule is "principles-based, providing that a determination made by the insurer at or prior to the issuance of a contract would be conclusive"[56] so long as the insurer's methodology and assumptions are reasonable, the insurer's computations are materially accurate, and the determination is sufficiently current.

The determination that a fixed annuity is outside the rule must be made by analyzing "expected outcomes under various scenarios involving different facts and circumstances,"[57] and may not be made more than three years prior to the date on which the contract is issued. The proposed rule thus would require the industry to prove repeatedly that a particular product continues to remain outside the rule in order for the product to rely on Section 3(a)(8).[58]

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[54] As noted above, surrender charges can not be deducted from amounts payable, but must be deducted from amounts guaranteed. See Proposed Rule 151A (b)(1); Proposing Release at 94.

[55] Proposing Release at 36. ("As with all exemptions from registration and prospectus delivery requirements of the Securities Act, the party claiming the benefit of the exemption – in this case, the insurer – bears the burden of proving that the exemption applies." Id. (footnote omitted)).

[56] Proposing Release at 35.

[57] Id. at 33.

[58] The Proposing Release does not address whether or when the insurer must stop sales of an unregistered annuity if it determines that the annuity falls within proposed rule 151A.

The Proposed Release uses only generalized terminology in describing the determination to be made, stating that the insurer will need to make assumptions in several areas, including "assumptions about (i) insurer behavior, (ii) purchaser behavior, and (iii) market behavior, and will need to assign probabilities to various potential behaviors."[59] These assumptions should generally "be guided by both history and [an insurer's] own expectations about the future".[60] In an attempt to clarify, the Commission noted that "[a]s a general matter, assumptions about insurer, investor or market behavior that are not consistent with historical experience would not be reasonable unless an insurer has a reasonable basis for any differences between historical experience and the assumptions used."[61] We note the inconsistency of this statement with the Commission's long held view that past performance of the markets should not be used as a projection of future performance.

With regard to determining whether an insurer's methodology is reasonable, the Commission notes that "it would be appropriate to look to methods commonly used for valuing and hedging similar products in insurance and derivative markets."[62] Yet, the Commission acknowledges that there may be a "range of methodologies and assumptions" that are reasonable, so that reasonable methodologies and assumptions "may differ" from one insurer to another, thereby giving insurers very little in terms of authoritative guidance on appropriate methodologies and assumptions.[63]

The Committee, however, is concerned that the probabilities and calculations that form the basis of the insurer's determination are based on the insurer's own assumptions about future outcomes of the market and customer behavior. While the Commission states that it would look to the methodology an insurer commonly uses for valuing and hedging similar products, such economic and actuarial methodologies traditionally have been used by insurers solely for business projections and have not been designed to withstand the scrutiny of regulators and litigators. In addition, the computations supporting the determination must be documented and be "materially accurate," yet the Commission gives no guidance on the level of assurance (whether provided by third parties or senior company officers) that would be required to support such calculations and gives no projections of the costs to insurers of obtaining such assurances.

The Committee is also concerned that the basic test outlined in the proposed rule does not make sense and will lead to illogical results. Take the following example:

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[59] Id. at 37 (emphasis added).

[60] Id. at 38 (emphasis added).

[61] Id.

[62] Id. at 37.

[63] Id.

- Product A guarantees 1% interest plus 100% of the increase in the S&P 500 index in excess of 20% for the upcoming year.
- Product B guarantees 3% interest plus 10% of the increase in the S&P 500 index in excess of 3% for the upcoming year.

Under proposed rule 151A, an annuity must be registered if the "[a]mounts payable by the insurer are more likely than not to exceed the amounts guaranteed under the contract." Because it is unlikely that the S&P 500 index would have returns in excess of 20% per year, Product A would not be deemed to be security since the amount payable has less than a 50% chance of exceeding the guaranteed amount. But Product B would be deemed to be security because the it is more likely than not that the S&P 500 index would return more than 3% per year, so that the amount payable would have a more than a 50% chance of paying more than the guaranteed amount. The insurer's guarantee under Product A is less than the guarantee under Product B, but the likelihood of paying an excess amount in Product A is also much less certain than under Product B. Proposed rule 151A would lead to the conclusion that a product with a lesser guarantee (Product A) is not a security because it would fall outside the proposed rule 151A test, but the product with the more robust guarantees (Product B) would be a security. This outcome appears to be illogical.

The Committee urges the Commission to rethink its approach to this rule. Even if the Commission narrows the rule, but keeps the same framework intact that requires insurers to make determinations subject to various conditions, the Committee still fears that courts and the industry will struggle for years with interpretations of the rule in hindsight, potentially imposing significant and unwarranted costs that could burden the industry.

II. Alternative Approach to Proposed Rule 151A

As noted above, it is the Committee's view that any rule interpreting Section 3(a)(8) must consider not only the investment risk borne by the consumer, but also the investment risk borne by the company, as well as other relevant factors. The Committee also believes that, like Rule 151, an alternative rule addressing indexed annuities should be crafted as a safe harbor, so that annuities fitting within the safe harbor are given certainty and those not fitting within the safe harbor could nonetheless qualify for the Section 3(a)(8) exemption, depending upon the total facts and circumstances.

To assist the Commission, the Committee is in the process of crafting the framework for an alternative "safe harbor" rule that would address indexed annuities. The alternative rule would include a balanced investment risk assumption test, a disclosure requirement, a marketing test with concrete criteria, and other market conduct components. If the specified components of the rule are met, then the product would be deemed to fit within the Section 3(a)(8) exclusion from the federal securities laws.

The Committee is still evaluating various alternative proposals and requests that the Commission provide the Committee with additional time in which to prepare and present to the Commission a more detailed outline of an alternative rule proposal.

III. Reform Is Necessary to Level the Playing Field for Registered Fixed Annuities and Registered Variable Annuity Products

Before the Commission adopts any proposal that would result in the registration of fixed annuity products, the Committee strongly urges the Commission to propose and adopt a package of rule proposals that would level the SEC regulatory landscape for registered fixed annuity products relative to that of registered variable annuity products.[64]

A. Registration on Form S-1 Is Expensive, Ill-Suited and of Limited Value to Annuity Purchasers, So That the Commission Should Either Amend Form S-1, Permit Use of Form N-4 or Develop Another More Appropriate Form for Registered Fixed Annuities

Many annuity issuers find the current 1933 Act framework applicable to the registration of fixed annuity contracts to be expensive, unwieldy, ill-suited for the continuous offering of securities, and of fairly limited value to investors. When registering a fixed annuity, the Commission should either: (i) amend Form S-1 to eliminate unnecessary information immaterial to fixed annuity purchasers; (ii) permit insurers to use a modified Form N-4, or (iii) propose and adopt a new, customized registration form that does not clutter and obscure disclosure about the fixed annuity contract by including large amounts of irrelevant and immaterial company-related disclosure.

Unlike variable annuities that are registered on Form N-4,[65] annuities that are not funded through an investment company vehicle are currently required to register the insurance company's general account under the 1933 Act on either Form S-1 or Form S-3,[66] the "catch-all" form for registration under the 1933 Act.

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[64] The life insurance industry made a similar argument to the SEC in 1995 in response to Chairman Levitt's request for input to the SEC's Internal Task Force on Disclosure Simplification. See Letter to Chairman Levitt, U.S. Securities and Exchange Commission, from Robert S. McConnaughey, ACLI (Oct. 31, 1995).

[65] Form N-4 serves to register both the separate account as a unit investment trust under the Investment Company Act of 1940 (the "1940 Act") and the variable annuity contract under the 1933 Act.

[66] Certain S-1 issuers that meet the Registrant Requirements specified in the form (such as filing reports under the 1934 Act for at least twelve calendar months immediately preceding the filing of the registration statement) may use Form S-3 for the registration of securities under the 1933 Act, provided the securities are offered in any transaction specified in the form (the Transaction Requirement).

The focus of the Form S-1 and Form S-3 prospectus is on the insurance company, and not on the annuity contract being offered. In contrast, under Form N-4, the focus of the prospectus is on the variable annuity contract being offered; the insurance company that issues the contract and provides the contract guarantees is treated for disclosure purposes as the depositor of the separate account with very limited disclosure obligations in the prospectus.[67]

The disclosure about the insurer for the fixed annuity contract registered on Form S-1/S-3 must meet all the applicable requirements of Regulation S-K, including, among other disclosures, a discussion of the general development of the business of the insurance company, its subsidiaries and any predecessors during the past five years.[68]

Unlike Form N-4, the insurance company must also provide (or incorporate by reference) in Forms S-1 and S-3 management's discussion and analysis ("MD&A") of its financial condition and results of operations (including liquidity, capital resources and reported income). MD&A generally must address the three-year period covered by the audited general account financial statements required to be included in the fixed annuity prospectus (as well as any interim periods required to be presented under Regulation S-X).[69] Form S-1 would also require that the financial statements of the issuer be placed in the prospectus.[70]

Also unlike Form N-4, Forms S-1 and S-3 call for detailed disclosure regarding the directors and executive officers of the insurance company, including their background, involvement in legal proceedings, transactions with the insurance company, and extensive disclosure on executive compensation.[71]

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[67] Other than stating the name, owner and address of the depositor, Forms N-4 and N-6 only require disclosure that the insurance company is responsible for certain benefits under the insurance contract. The Forms also require the insurance company to include its audited financial statements in the filing, to disclose certain legal proceedings against the depositor, and to have the registration statement signed by the depositor and its officers and directors. However, the Forms do not require the insurance company to provide disclosure regarding the investments in its general account or its risk management strategy or to provide management discussion and analysis regarding the insurer's past or future operations.

[68] See Item 101 of Regulation S-K.

[69] See Item 301 and 303(a) and (b) of Regulation S-K and generally, Articles 3, 10 and 11 of Regulation S-X.

[70] The Committee proposes instead that issuers be permitted to include financial statements in Part II of the registration statement (similar to Form N-4 and Form N-6's placement of the financial statements in the statement of additional information), as long as the issuer provides financial statements on request to any prospective or existing contract owner and the prospectus includes a toll-free number and address to submit requests for financial statements.

[71] See Items 401 and 402 of Regulation S-K.

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Forms S-1 and S-3 are not designed for the registration of annuity contracts. Much of the information that Regulation S-K required to be included in the prospectus for a registered fixed annuity is simply not relevant to annuity purchasers. Thus, the extensive disclosures about the insurance company (e.g., MD&A and executive compensation disclosures), while appropriate for a public company registrant, distract unnecessarily from the investor's focus on the features, costs, and benefits of the annuity contract, and confuse prospective owners about the nature of security they are purchasing. The Commission, therefore, should propose and adopt rules that streamline the prospectus disclosure requirements for registered fixed annuities so that such prospectuses are concise, easy to read and relevant to annuity purchasers. The Committee believes this issue is sufficiently important that these rules should be adopted before the Commission adopts any proposal that would result in the registration of fixed insurance products.

B. Fixed Annuities Should Be Permitted to Register an Indefinite Amount of Securities, Pay Net Fees In Arrears, and Have Post-Effective Amendments Declared Effective Automatically

Like variable annuity contracts, fixed annuities are offered on a continuous basis. Variable annuities, however, are deemed by Section 24(f) under the 1940 Act to register an indefinite amount of securities, pay registration fees in arrears and net of redemptions, and provide for the automatic effectiveness of post-effective amendments to registration statements under Rule 485(b) of the 1933 Act in recognition of the recurring need to file updated post-effective amendments to the registration statements.

Section 24(f) and Rule 485 are not available to non-investment company registrants such as issuers of fixed annuities. Insurance company registrants must pay non-refundable registration fees in advance with the initial registration statement based on the amount of securities they estimate will be sold in the first few years of the offering; track the amount of securities sold with care; and register new securities on a new registration statement and pay new registration fees in advance of exhausting all securities previously registered. All registration statements (and amendments thereto) filed on Form S-1 and S-3 must be declared effective after SEC staff review and do not permit automatic effectiveness.

Given the similarities between the continuous offering of fixed annuity contracts and the continuous offering of variable annuity contracts, before the effective date of any rule proposal clarifying the status of fixed annuities, the Commission should propose and adopt rules that permit registered fixed annuities to register an indefinite amount of securities, to calculate fees net of redemptions and to pay fees in arrears, and to permit automatic effectiveness of post-effective amendments to registration statements under appropriate circumstances.

C. Permit the Use of Statutory Financials in Fixed Annuity Registration Statements

Regulation S-X requires that all financial statements included in a Forms S-1 and S-3 registration statement be prepared in accordance with generally accepted accounting principles ("GAAP"), with the limited exception of financial statements for mutual life insurance companies and wholly-owned stock insurance company subsidiaries of mutual life insurance companies which may be prepared in accordance with statutory accounting requirements.[72] However, insurance companies that register as depositors to their separate accounts funding variable annuities on Form N-4 are permitted to prepare and file audited statutory financial statements if the only reason the insurance company would prepare GAAP financial statements is to accompany the registration statements for its registered variable insurance products. [73]

The Committee requests that before the effective date of any rule clarifying the status of fixed annuities, the Commission propose and adopt rules that would permit insurance company registrants on Forms S-1 and S-3 to avail themselves of the same exceptions from GAAP reporting as are in place for insurance company depositors on Forms N-4 and N-6.

D. Registered Fixed Annuities Should Be Permitted To Advertise Performance in a Manner Similar to Variable Annuities and Mutual Funds

Rule 482 under the 1933 Act is a flexible rule that permits investment companies registered under the 1940 Act, including issuers of variable annuities and mutual funds, to advertise their products in advance of delivery of the statutory prospectus and to include information the substance of which is not included in the statutory Section 10(a) prospectus.[74] Rule 482 advertisements are especially attractive because they may also include performance information. Variable annuities and mutual funds may also rely on Rule 34b-1 under the 1940 Act, which provides guidelines for the inclusion of performance data in supplemental sales literature.

However, 1933 Act registration of fixed annuities does not permit the use of Rule 482 advertisements in advance of the delivery of the statutory prospectus similar to what is permitted for mutual funds and variable annuities. Instead, Rules 433 and 164 under

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[72] See Rule 7-02(b) of Regulation S-X.

[73] See Instruction 1 to Item 23(b) of Form N-4 and Instruction 1 to Item 24(b) of Form N-6.

[74] Section 24(g) of the 1940 Act was adopted by Congress as part of NSMIA to permit the SEC to adopt amendments to Rule 482 permitting information the substance of which is not in the prospectus to appear in Rule 482 advertisement for registered investment companies. We note, in this regard, that the SEC does not have similar statutory authority to adopt a rule permitting fixed annuities to use materials the substance of which is not in the prospectus.

the 1933 Act, adopted in 2005 as part of the Commission's "Securities Offering Reform" initiative, govern the use of written marketing communications constituting offers outside the statutory prospectus. These rules refer to these types of marketing communications as "free writing prospectuses."[75]

Rule 433 has numerous conditions, including a requirement that in most circumstances free writing prospectuses used in an offering of securities where the issuer is not a "well-known seasoned issuer" ("WKSI"), or the offering is not otherwise eligible for "short-form registration" on Form S-3, be preceded or accompanied by a statutory prospectus.[76] What this means is that many, if not most, insurers issuing registered fixed annuity contracts will be prohibited from using general advertising and other forms of marketing materials that as a practical matter cannot be preceded or accompanied by a statutory prospectus.

The Committee believes strongly this would be an inequitable and likely unintended result and is not warranted by the Commission's policy in adopting the limitations in Rule 433, which was that "conditioning the use of the free writing prospectus on its being preceded or accompanied by the statutory prospectus will assure that an investor has a balanced disclosure document of an issuer with no or limited reporting history against which to evaluate the free writing prospectus and to place the statements made in context."[77] In this context, whether the issuer of a registered fixed annuity contract has a limited 1934 Act reporting history would not appear to be important, as acknowledged by the Commission in its proposal to exclude issuers of registered fixed annuity contracts from filing periodic reports under the 1934 Act.[78] Instead, the Committee believes that it would be appropriate to use Rule 482-type marketing materials with registered fixed annuity contracts.

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[75] See generally Section III of "Securities Offering Reform," Rel. No. 33-8591, 34-52056 (July 19, 2005).

[76] See Rule 433(b)(2). It is important to recognize in this regard that although the ultimate parent companies of many U.S. insurance companies are public companies, registered annuity contracts such as variable annuity contracts have traditionally been issued by direct or indirect wholly-owned subsidiaries of these public companies that are not WKSIs and cannot use Form S-3. We expect the same situation will hold for other types of registered annuity contracts, including any that would be required to be registered by proposed Rule 151A.

[77] The Commission acknowledged in the release adopting Rule 433 that the use of broadly disseminated free writing prospectuses in registered offerings by non-reporting or unseasoned issuers and offering participants in these offerings "may not be feasible unless they are in electronic form and contain a hyperlink to the statutory prospectus."

[78] See Proposing Release at 50 (proposing Rule 12h-7 under the 1934 Act).

IV. Extension of the Proposed Effective Date

The Commission proposes to have the effective date of an adopted rule be a date that is 12 months after publication of the final rule in the Federal Register. The Commission recognizes that, if rule 151A is adopted as proposed or if any rule is adopted that would require registration of currently unregistered insurance or annuity products, "the industry will need sufficient time to conduct the analysis required by the new definitional rule and comply with any applicable requirements under the federal securities laws."[79] The Commission requests comment on whether the effective date of the new rule, if adopted, should be 12 months after publication in the Federal Register, or should it be effective sooner or later.

Members of the Committee issuing indexed products which would be affected by the proposed rule believe that it would take substantially longer than 12 months to effectively come into compliance with the proposed rule. The analysis that the proposed rule would require insurers to conduct would need to be developed out of whole cloth in consultation with appropriate third party experts. Perhaps more importantly, however, after any required analysis is developed and conducted, and insurers determine that certain products would no longer be excluded pursuant to Section 3(a)(8), a number of difficult and time consuming decisions and next steps would need to be taken.

- Many of the companies issuing these products may never before have registered products with the Commission. Given that registration would need to be effected, it likely would take approximately 12 months alone to prepare registration statements and to obtain the necessary orders of effectiveness from the Commission after staff review. If companies are required to use Form S-1, registration will present additional challenges, requiring, as discussed above in Sections III., the preparation of extensive new disclosures about the insurance company and the product, and the preparation and auditing of GAAP financial statements.

- If the company determines to stop selling an existing product, and instead to develop and register a new product,[80] more time (and significant cost) would be entailed in designing that new product, performing necessary actuarial testing and analysis, drafting the policy form, and filing the policy form and obtaining any necessary state insurance regulatory approvals.

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[79] Proposing Release at 45.

[80] Insurers will need to evaluate the feasibility of registering existing products with the Commission in a manner that both avoids disruption of their business and also complies with Section 5 of the 1933 Act during the pre-filing and waiting periods. The Commission did not address this issue in the Proposing Release.

- The process of converting an insurance distribution channel to a securities model, including organizing and registering broker-dealers, developing necessary compliance and administration systems, licensing and training of insurance agents, and changing methods of doing business in order to comport with applicable SEC and FINRA regulations would itself be a major undertaking requiring significantly more than 12 months.

Taking these and other factors into account, including the importance of reforming the SEC regulatory framework as discussed above, it would appear that 24, not 12, months after publication of an adopted rule in the Federal Register will be necessary to meet such extensive requirements.

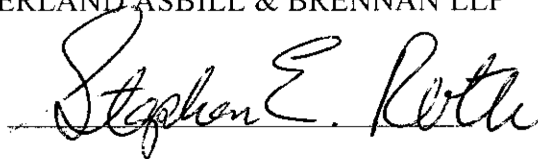
V. Conclusion

The Committee appreciates the opportunity to comment on the Proposing Release and respectfully asks that the Commission consider its comments with regard to the consequences that proposed rule 151A could have for annuity writers if adopted as proposed. And as noted above in Section II, given the diverse interests of Committee members and the shortness of the comment period, the Committee requests that the Commission provide the Committee with additional time in which to prepare and present to the Commission a more detailed outline of an alternative rule proposal.

If you have any questions or if additional information would be helpful, please contact Steve Roth at 202.383.0158 (steve.roth@sutherland.com), Mary Jane Wilson-Bilik at 202.383.0660 (mj.wilson-bilik@sutherland.com) or Fred Bellamy at 202.383.0128 (fred.bellamy@sutherland.com).

Respectfully Submitted,

SUTHERLAND ASBILL & BRENNAN LLP

BY: 

BY:

BY:

FOR THE COMMITTEE OF ANNUITY INSURERS

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APPENDIX A

THE COMMITTEE OF ANNUITY INSURERS

AEGON USA, Inc.
Allstate Financial
AIG Life Insurance Companies
AVIVA USA Corporation
Commonwealth Annuity and Life Insurance Company
Conseco, Inc.
Fidelity Investments Life Insurance Company
Genworth Financial, Inc.
Great American Life Insurance Co.
Guardian Insurance & Annuity Co., Inc.
Jackson National Life Insurance Company
Life Insurance Company of the Southwest
Lincoln Financial Group
Merrill Lynch Life Insurance Company
Nationwide Life Insurance Companies
Northwestern Mutual Life Insurance Company
OM Financial Life Insurance Company
Pacific Life Insurance Company
Protective Life Insurance Company
Prudential Insurance Company of America
RiverSource Life Insurance Company
(an Ameriprise Financial company)
Sun Life Financial
Symetra Financial
The Phoenix Life Insurance Company
USAA Life Insurance Company